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Analysis of Business Trends Plus Selected Financial Indicators

Fractured Harmony

Despite the best efforts of European governments to forge an unprecedented degree of economic and monetary union by the end of this decade, the pronounced turbulence buffeting the Exchange Rate Mechanism (ERM) of the European Monetary System underscores the difficulty of achieving such a visionary venture when business conditions, and appropriate policy remedies diverge across national frontiers. For notwithstanding the reaffirmation of commitments to European unity by a broad spectrum of Europe's political leadership, the fact is that the fracturing of intra-European exchange rate harmony stems from the deteriorating economic position and prospects of several of the principal European economies.

Because of this, worried investors fear that the strict economic discipline which is part and parcel of the runup to monetary union will be the first thing jettisoned. The doubters won a round when such economically-pinched European Community members as the United Kingdom and Italy decided they could no longer subordinate domestic policy interests to the pursuit of such pan-European objectives as budget discipline and monetary restraint. Yet, while the odds favoring European unity may have lengthened, they are by no means dashed. Paradoxically, the unity drive among the stronger economies is alive and well, and may have even gotten a boost from the current turmoil.

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Perhaps the principal contributor to Europe's autumn of discontent is the persistence of a tight-fisted monetary policy in Germany, which has blanketed not only that country, but the rest of the European Community as well, with a punishingly lofty level of short-term interest rates. Stressing repeatedly its discomfort with the prevailing rate of inflation, a torrid pace of money supply growth and a ballooning public sector deficit, the German central bank has unflinchingly pursued a policy designed to rein in domestic price pressures and set the stage for Germany itself to satisfy the strict economic prerequisites required for full participation in economic and monetary union.

The good news is that the Bundesbank's efforts have achieved a fair degree of success. Although money and credit growth still hover well above desired levels, significant progress has been made in dampening price pressures. Whereas the inflation rate had appeared poised to vault above the five percent level as recently as six months ago, and a nationwide round of wage negotiations threatened to provide even more fuel to the price fires, the steadfastness of the central bank ensured that neither came to pass. The widely-feared spring wage round passed with more of a pop than a bang and an accelerating rate of inflation suddenly lost its gusto, and has since retreated toward the 3½ percent neighborhood. To be sure, the German economy has slowed to a crawl in the wake of repeated rounds of monetary restraint—contracting in four of the past five quarters—but this is apparently viewed as an acceptable consequence of the efforts to achieve price stability.

Litmus Tests

While passing its own self-imposed, inflation-fighting litmus test at home, the bad news is that the Bundesbank was arguably failing the same test abroad. According to the critics, by relentlessly pursuing its domestic agenda, the German central bank was neglecting its pan-European responsibilities by inadvertently locking the rest of the continent into a prolonged period of economic stagnation (Financial Digest—July 27, 1992). And, herein lies the rub—in the form of not only the seeds of instability within the foreign exchange markets but also the groundswell of doubts surrounding the staying power of the unity-forging Maastricht Treaty.

Nowhere was the bite of Germany's monetary policy harsher than in the United Kingdom and, not coincidentally, nowhere was it more resented. Although finding itself in the midst of its lengthiest recession since the 1930s, UK policymakers were unable to unilaterally relax monetary policy and still keep sterling within the confines of its permitted ERM band. Equally rankling was the fact that while Germany is experiencing an inflation problem, the United Kingdom wasn't; it had trimmed the inflation rate from a lofty 11 percent perch in mid-1990 to nearly 3½ percent by the middle of this year.

Nor were rumblings of discontent confined to the United Kingdom. In early June, voters in Denmark threw a monkey wrench in the unity

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drive by narrowly rejecting the strictures of the Maastricht Treaty, viewing unfavorably the prospect of a single European currency and one, presumably German-dominated, central bank. Although the Treaty escaped the same fate at the hands of the French electorate, it was approved by the most minute of margins, as voters carefully weighed the promised benefits of a united Europe against the stark reality of a sagging economy and a double-digit unemployment rate. And, in Italy, no one doubts that meeting the economic criteria for participation in monetary union will be difficult, requiring unaccustomed budget discipline, painful public spending cuts and prolonged monetary restraint.

Cherry Picking

Sensing the stresses building around the edges of the European Community, and seemingly concluding that the serpentine road to unity was just too difficult for some countries to bear, the investment community ran for the exits, largely from the securities and currencies of those countries where the likelihood of Maastricht-imposed inflation and public policy discipline seemed dimmest. In short order, the currencies of the United Kingdom, Italy and Spain were driven sharply lower—so low, in fact, that the United Kingdom and Italy threw in the towel and withdrew from Europe's exchange rate arrangements altogether.

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/16/92)	133,208	- 1,608	- 47,520
New York City (9/23/92)	24,516	- 949	- 5,248
Commercial Paper (9/23/92)	551,282	+ 1,026	+ 18,405

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/16/92)	277,052	+ 2,597	- 23,224
New York City (9/23/92)	46,809	- 986	- 6,435

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/16/92)	993,528	+10,057	- 24,213
New York City (9/23/92)	156,614	- 4,585	- 14,048

Financial Markets

	Friday 10/2/92	Change Since Week Ago	Change Since Year Ago
U.S. Governments, 2 p.m. Yields:			
90-Day Bills†	2.68%	- .21	- 2.46
180-Day Bills†	2.87	- .06	- 2.40
Longest Bills†	2.97	- .09	- 2.35
Recent Issues:			
4s 9/30/94	3.68	- .12	
5½s 9/30/97	5.20	- .14	
6⅜s 8/31/02	6.23	- .18	
7½s 8/31/22	7.32	- .04	
Municipals:			
Bond Buyer—20 Bond Index* (10/1/92)	6.27%	- .06	- .37
Blue List Total ($ Million)	$1,169	- $286	- $ 124
30-Day Visible Supply ($ Million)	$8,574	+ $260	+$6,187
Total	$9,743	- $ 26	+$6,063
Corporates:			
Moody's Aa Composite (10/1/92)	8.16%	- .07	- .63
30-Day Visible Supply ($ Million)	$1,364	+ $395	+$1,089
Stocks: (Thursday)			
Dow-Jones Averages:			
Industrials	3,200.59	- 49.73	+238.83
Transportation	1,246.75	- 26.59	+ 58.41
Utilities	217.70	- 1.38	+ 5.07
65 Stocks	1,129.47	- 17.75	+ 67.32
N.Y.S.E. Composite Index	225.81	- 1.92	+ 15.59
N.Y.S.E. Avg. Daily Vol. for Week (000's)	198,699	+ 9,243	+35,597

*34% Taxable equivalent 9.50%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/2/92	Week Ago
Overnight	2.81%	3.06%
1 month	2.88	3.30
3 month	3.00	3.31
6 month	3.06	3.38
1 year	3.19	3.50

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/2/92)	Currency Per U.S. $	Week Ago
Belgium	29.19	30.46
Canada	1.2509	1.2435
France	4.7874	5.0102
Germany	1.4170	1.4775
Italy	1242.38	1247.00
Japan	119.67	120.77
Mexico	3107.00	3085.00
Netherlands	1.5955	1.6682
South Korea	800.00	800.00
Switzerland	1.2379	1.2997
Taiwan	24.91	25.03
U.K.*	1.7410	1.7050

*U.S. $ per U.K. pound

CHEM TRADE-WEIGHTED DOLLAR (10/2/92) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+1.1%	-17.5%

But while it may have been relatively easy for investors and speculators to "cherry pick" the soft spots in the ERM, this flare-up hardly buries either the drive toward European unity in general, or the ERM in particular. For one thing, despite the criticism leveled at Germany, the fact is that German inflation is past its peak and so, too, are German short-term interest rates. As interest rates recede, and growth prospects brighten, the genesis of today's turmoil, and cross-border "finger pointing" will fade. For another, as the acrimony fades, the realization will set in that, no matter how heatedly denied, a "two-speed" Europe does exist. This may actually be a plus. Convinced that the long-run benefits of economic union far outweigh the short-run costs, the stronger economies—largely the original six European Community members, minus Italy—might accelerate the unity process among themselves, providing a prosperous paragon which the weaker economies will seek to emulate as quickly as possible. And, finally, the asymmetry of the ERM will be corrected. Largely designed to combat inflation and prepare for monetary union by ensuring exchange rate stability, it will be made capable of calmly realigning itself when quicker growth conditions are required—presumably starting with more diligent member oversight.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/30/92	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	301.868	+ 9.643	+37.699
Loans to Depository Inst.	.299	+ .081	- .045
Float	.182	- .324	- .195
Total Reserve Bank Credit	335.338	+10.317	+39.203
Treasury Deposits with Federal Reserve Banks	21.297	+ 7.600	+12.899
Currency in Circulation	317.356	- .831	+23.774
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	283.556	+ 1.213	+33.857
	9/30/92		
Member Bank Reserves:			
Total Reserves Held	50.977	- .495	+ .812
Excess (Deficiency)	1.290	+ .538	+ .246
Net Free Reserves	1.031	+ .600	+ .329

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (9/21/92)	991.5	+ 13.0	+ 13.1
M2 (9/21/92)	3.479.6	+ 1.6	+ 1.9
M3 (9/21/92)	4.178.2	+ 1.3	+ 0.5
Domestic Nonfinancial Debt (1st Q'92)	11.304.3	+ 3.9	+ 4.5

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 10/2/92	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	2.63%	2.81%	2.89%
* Federal Agencies	2.85	2.95	3.10
* Municipal Notes–High Grade (34% Taxable Equivalent)	3.94	4.02	4.09
Negotiable Time CDs			
Chemical	Rates By Arrangement		
* Secondary Market–Prime	2.75	2.75	2.85

‡ Finance Company Paper–Prime

5- 14 days	3.05%
15- 29 days	3.10
30- 59 days	3.15
60- 89 days	3.15
90-179 days	3.25
180-239 days	3.30
240-270 days	3.30

‡* Bankers' Acceptances

Nov.	2.98%
Dec.	3.02
Jan.	3.00
Feb.	2.99
Mar.	2.98
Apr.	2.98

‡ Industrial Paper–Prime

30- 89 days	2.95%
90-120 days	3.00

†Federal Funds Effective Rate 2.25%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross Domestic Product (Current Dollars)*	2nd Q'92	$ 5,902r	$ 5,840	$ 5,658
Gross Domestic Product (1987 Dollars)*	2nd Q'92	$ 4,892r	$ 4,874	$ 4,817
Percent Change, Annual Rate	2nd Q'92	1.5r	2.9	1.7
Change in Consumer Prices*	Aug '92	3.6%	1.2%	3.6%
Change in CHEM Cost of Living Index*	Aug '92	6.0%	1.2%	4.8%
Change in Producer Prices*	Aug '92	1.2%	1.2%	2.4%
Civilian Employment (Thousands of Persons) †	Sep '92n	117,701	117,737	117,089
Unemployment as % of Civilian Labor Force †	Sep '92n	7.5%	7.6%	6.8%
Personal Income*	Aug '92n	$ 5,027	$ 5,051r	$ 4,848
Leading Indicators Composite Index (1967=100) †	Aug '92n	149.4	149.7r	145.6
Industrial Production Index (1977=100) †	Aug '92	108.6	109.2	108.0
Net Change in Consumer Installment Credit †	Jul '92	- $ 1.12	- $ 0.28	- $ 1.29
U.S. Merchandise Trade Balance †	Jul '92	- $ 7.82	- $ 6.73	- $ 5.63
Plant and Equipment Expenditures*	4th Q'92	$ 562.4(a)	$ 565.2(a)	$ 528.9
Private Housing Starts (Thousands of Units)*	Aug '92n	1,237	1,120r	1,053
New Construction Expenditures*	Aug '92n	$ 424.0	$ 427.5r	$ 404.8
Total Business Inventories †	Jul '92	$ 832.9	$ 831.9	$ 819.9
Total Business Sales †	Jul '92	$ 558.5	$ 554.4	$ 538.9

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure r-Revised. a-Anticipated.

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